SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1943

No. 1012

REPPLIER COAL COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

No. 1013

REPPLIER COAL COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

The Questions Presented.

The questions presented are stated in the petition.

Statutes and Regulations Involved.

The statutes and regulations involved are set out in the Appendix, pp. 24-28.

Statement.

The facts are stated in the petition.

Specifications of Errors to Be Urged.

The Court below erred:

1. In holding that the question of whether the cost of a mine tunnel (to maintain the established production of a mine long past the development stage) is a currently deductible expense, is a question of fact upon which the decision of the Tax Court was final.

2. In holding that because petitioner claimed percentage depletion, it should be denied the right to deduct, as an ordinary and necessary operating expense, the cost of a mine tunnel to maintain the established output of its mine which was long past the development stage.

3. In failing to hold that the cost of a mine tunnel to maintain the established output of petitioner's mine, which was long past the development stage, is a currently deductible expense.

4. In sustaining the decision of the Tax Court upon the point.

5. In holding that, in determining net income from petitioner's mining property within the meaning of Section 114 (b) (4) of the Revenue Acts of 1934 and 1936, the question of whether petitioner's cost of miners' labor was (a) the amount of money paid plus the contract price at which the petitioner furnished miner's supplies to its miners, or (b) the amount of money paid by petitioner plus the cost to it of such supplies, was a question of fact upon which the decision of the Tax Court was final.

6. In failing to hold that, in determining such net income from said mining property, petitioner's cost of miners'

labor was no more than the amount of money it paid its miners plus the cost to it of said supplies.

7. In sustaining the decision of the Tax Court upon the point.

8. In failing to hold that where, acting under a mutual mistake of law, the petitioner erroneously claimed, and the Commissioner erroneously failed to disallow excessive depreciation in prior years, the Commissioner should not be heard to urge his own error as the basis for reducing petitioner's depreciation base on account of such excessive depreciation, to any extent in excess of the benefit derived by petitioner from such error.

9. In holding that petitioner's depreciation base should be reduced by depreciation theretofore claimed to any extent beyond the amount thereof found allowable by the Tax Court, plus the amount thereof which offset taxable income.

10. In failing to hold that the decision of the Tax Court on the point was final and not subject to review.

11. In failing to sustain the decision of the Tax Court on the point.

ARGUMENT.

I.

The Decision Below That the Questions of (a) Whether the Cost of a Tunnel to Maintain Mine Output Is a Currently Deductible Expense, and (b) Whether the Cost of Miners' Labor Was the Actual, or a Theoretical, Amount Thereof, Are Questions upon Which the Determination of the Tax Court Is Final, Appears to Conflict With the Applicable Decisions of This Court.

To this petitioner, it appears that the Court below misinterpreted this Court's recent decision in *Dobson* v. *Com-*

missioner of Internal Revenue, — U. S. —, 64 S. Ct. 239, 88 L. Ed. Ad. Op. 179, petition for rehearing denied — U. S. —, 64 S. Ct. 475, 88 L. Ed. Ad. Op., p. 459. As construed by us, the doctrine of that decision is that the question of whether a series of acts amounts to one single, or several separate, transactions, for tax purposes, is a question of fact upon which a decision of the Tax Court is final. We do not understand the *Dobson* case to have overruled, either expressly or by implication, either this Court's numerous decisions that determinations of the Tax Court on matters of law are reviewable, or the recent decision of this Court in *Helvering* v. *American Dental Co.*, 318 U. S. 322, in which it was said, pp. 330, 331, "We do not feel bound by the finding of the Board because it reached its conclusions, in our opinion, upon an application of erroneous legal standards. Section 22 (b) (3) exempts gifts. This does not leave the Tax Court of the United States free to determine at will or upon evidence and without judicial review the tests to be applied to facts to determine whether the result is or is not a gift." The question presented in the *American Dental* case was a question of law, upon which a decision of the Tax Court was subject to review; and, in our case, the question of whether the cost of the tunnel was deductible as an ordinary and necessary operating expense was, we submit, also a question of law which the Court below should have reviewed and corrected. There was no question of fact. The facts were stipulated. The only question was the question of law of whether the cost of a mine tunnel to maintain production was so deductible. The Tax Court did not purport to decide the question as a question of fact. It held that the expenditure was not deductible because the Tax Court thought it involved a "double deduction" and "deductions for depletion on both the percentage and cost bases." That decision, we submit, was a reviewable decision of law.

In like manner, all the facts concerning the cost of miners' labor, to be deducted in arriving at the percentage depletion limitation, were stipulated; and the only question was the question of law as to whether a theoretical, or the actual cost of such labor was so to be deducted in arriving at net income from the property within the meaning of Section 114 (b)(4) of the Revenue Acts of 1934 and 1936. While, on this point of the cost of labor, the Tax Court did state, "The situation is the same as if the miners had received their entire wages in cash and had then purchased the supplies," and "the essential nature of the situation * * * was * * * the payment of wages in full and the realization of a profit upon a distinct and separate transaction," that was not a finding of fact, but a conclusion of law. The fact was just the opposite. The miners did not receive their entire wages in cash, but received the same partly in cash and partly in supplies which had cost the petitioner less than the contract prices at which they were furnished to the miners.

We urge that the decision below erroneously interprets this Court's decision in the *Dobson* case on an important and fundamental question of federal income tax law; and that the decision below should, therefore, be reviewed by this Court.

II.

The Decision Below, That the Cost of a Mine Tunnel to Maintain the Output of a Mine Long Past the Development Stage Is Not Currently Deductible, Is the Decision of an Important Question of Income Tax Which Has Not Been, But Should Be, Passed upon by This Court; It Conflicts in Principle With the Decisions of Three Other Circuit Courts of Appeals; and It Is Contrary to the Weight of Authority, the Published Ruling, the Regulations and the Practice of the Treasury Department, and Contrary to the Interpretation to Be Accorded the Statute Due to Repeated Re-enactment in the Light of the Authorities and Practice Mentioned.

On the issue concerning the deductibility of the cost of the tunnel, this case presents the only decision of which we are aware which varies from the long established rule that an expenditure made to maintain (and not to attain or increase) production, and where the mine has passed the development stage, is a deductible expense either in the year incurred or ratably over coal or ore made available.

The question of the current deductibility of such costs is important and recurrent throughout the mining industry. Mine tunnels, rock gangways and similar works are constantly becoming necessary in the operation of producing mines in order to reach the diminishing mineral and maintain production. So far as we have been able to find, this Court has never passed upon the point; but now that this case has appeared and announced a rule in contravention of that which has been followed and applied for many years, it is submitted that this Court should settle the matter.

The decision below enunciates a doctrine which is in direct conflict with the rule as laid down by three other Circuit Courts of Appeals in the only cases (except a prior case in

which the Circuit Court of Appeals for the Third Circuit rendered a decision at variance with its decision herein) of which we are aware, in which a Circuit Court of Appeals has considered the subject. Although in *Guanacevi Mining Company* v. *Commissioner*, 127 Fed. (2d) 49, the Circuit Court of Appeals for the Ninth Circuit held that the expenditure there in question was not deductible, that result was reached because it appeared that the tunnel under consideration in that case was built to *attain* an intended production, the mine not having passed the development stage, and the Court said, p. 51:

> "The teaching of the opinions in Marsh Fork Coal Co. v. Lucas, 4 Cir., 42 F. 2d 83, 85, 86, and Enterprise Coal Co. v. Phillips, D. C., Pa., 12 F. Supp., 49, 50, 51, affirmed 3 Cir., 84 F. 2d 565, impress upon us that if an expenditure is made to *attain* an intended output, it is properly chargeable to capital as a cost of development; if the expenditure is made to *maintain* an output, it is properly chargeable to operating expense."

In the *Marsh Fork Coal Co.* case, cited in the extract above, and in *Little War Creek Coal Co.* v. *U. S.*, 25 Fed. Supp. 764; aff'd 104 Fed. (2d) 483, the Circuit Court of Appeals for the Fourth Circuit decided that if an expenditure is made to maintain output, it is properly chargeable to operating expense. Accord, *U. S.* v. *Roden Coal Co.*, (C. C. A. 5), 39 Fed. (2d) 425, and the same Circuit Court of Appeals which decided the instant case reached a conclusion in harmony with the foregoing cases in *Enterprise Coal Co.* v. *Phillips*, cited in the above quotation from the *Guanacevi Mining Co.* case.

See also:

Norris & Montgomery "Uniform Classification of Accounts for Anthracite Coal Operators" (1919), p. 12.
W. B. Reed "Bituminous Coal Mining" (1922), p. 201.
C. E. Mengel "Anthracite Production Costs", Bulletin

of National Association of Cost Accountants, April 15, 1941.
G. C. M. 13954, C. B. XIII-2, 66.
Regulations 45, 1920 Edition, Article 222 (a).
Regulations 62, Article 222 (a).
Regulations 65, Article 224 (a).
Regulations 69, Article 222.
Regulations 74, Article 242.
Regulations 77, Articles 235 and 221 (h).
Regulations 86, Articles 23(m)-15 and 23(m)-1 (h).
Regulations 94, Articles 23(m)-15 and 23(m)-1 (h).

The provisions of the Revenue Acts concerning the deduction of expenses and depletion have remained substantially unchanged since 1918, except that a provision for percentage depletion first appeared in the Revenue Act of 1932. The latter provision was re-enacted without change in the Revenue Act of 1934 and in the Act here under consideration, to wit, the Revenue Act of 1936. In 1934, after holding conferences with, and receiving the briefs of, representatives of the mining industry, Mr. Justice Jackson, then Assistant General Counsel for the Bureau of Internal Revenue, issued G. C. M. 13954, C. B. XIII-2, 66, in which he reviewed the Treasury Department practice for the preceding fifteen years, and stated the considered position of his office, in part, as follows (p. 72):

> "In the case of mines there has never been a definite pronouncement in the Bureau regulations since Regulations 45, original 1919 edition, to the effect that capitalized development costs after the mine has reached the producing stage shall be charged to the capital account recoverable through depletion. On the contrary, for a considerable period (article 222 (a) of Regulations 45 (1920 edition) and Regulations 62 and article 224 (a) of Regulations 65) it was definitely provided that such development costs should be treated as

deferred operating expenses and deducted as such in the years to which applicable. It is true that beginning with Regulations 69 this express rule has been omitted from the Bureau regulations, but it appears to be far from certain that a practice to the contrary was established after such omission. Since Regulations 69 the Bureau regulations in reference to the capitalization of mine development costs have provided only that all expenditures during the development stage shall be charged to the capital account recoverable through depletion. As has been indicated heretofore, the definition of the term 'operating cost' in article 206 (d) of Regulations 69 (and see article 226 (d), Regulations 74, and article 227 (d), Regulations 77) has been left in such form as to imply that such term includes all costs which are not expressly required to be charged to the depletion account. * * *

"Accordingly, it is the opinion of this office that the capital to be recovered through depletion allowance under the general rule set forth in section 114 (b) 1 of the Revenue Acts of 1932 and 1934 which the percentage depletion allowances under such Acts are to be taken in lieu of, is composed in part of the capitalized development expenditures during the development stage of the mine; and that so-called capitalized development costs after the mine has reached the producing status should not be treated as capital charges recoverable through depletion, but as operating expenses deductible in the year in which the ore benefited by such expenditures is produced and sold. * * *"

Following this ruling, the Revenue Act of 1936 was enacted without any change from the Revenue Act of 1934, which would be material to this issue.

We submit that the Court below erred on this important question and that this Court should review that decision.

III.

It Is Respectfully Suggested That This Court Should Review the Decision Below and Settle Whether the Rule Laid Down by It in the Virginian Hotel Case Is to Be Deemed Modified by This Court's Subsequent Decision in the Dobson Case.

In the petition herein, the seventh of the reasons expressed for granting the writs outlines the doubts which, it is believed, may exist in the minds of taxpayers as to whether, in view of this Court's disapproval of the "bad debt" cases in its decision in the *Dobson* case, the prior decision in the *Virginian Hotel* case, (which apparently approved, if it did not rely upon, the "bad debt" cases), represents the present views of this Court.

In addition, the Tax Court having found herein that a part of the depreciation claimed in prior years was in fact excessive, and having found that such excessive depreciation had not been "allowed", except in part, we submit that this Court should settle whether the doctrine of the *Dobson* case is to be construed as hereinabove suggested by us under Point I, or whether, under that doctrine, the decision of the Tax Court on the depreciation point in this case should not have been held to be final by the Court below.

Further, the excessive depreciation claimed herein in prior years and not disturbed by the Commissioner, was based upon a mistake of law mutual to the petitioner and the Commissioner. It is believed that other cases may arise in which, as here, it may be urged that the Commissioner should not be heard to plead his own dereliction of duty, in failing to disallow unallowable depreciation, as a basis for penalizing the taxpayer to any extent beyond whatever benefit the taxpayer may have derived from the error. And we respectfully request this Court to decide whether such a

defense is available to a taxpayer and sufficient to remove from the compass of the rule of the *Virginian Hotel* decision, a case which might otherwise fall within it.

For the foregoing reasons, and particularly in view of the widespread importance of this depreciation issue, it is most respectfully suggested that this Court should review this case and resolve the doubts which have been mentioned.

Conclusion.

It is respectfully submitted that the petition for writs of certiorari herein should be granted.

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